No. 85-1029

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

IRVING STARKMAN, M.D., Trustee of the Irving Starkman, M.D., S.C. Defined Benefit Pension Fund and Trust, on behalf of himself and all others similarly situated,

Petitioner,

vs.

MARATHON OIL COMPANY, an Ohio corporation, H. D. HOOPMAN, C. H. BARRE, V. G. BEGHNINI, H. H. HERING, and W. E. SWALES,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTIONS PRESENTED

1. Has the Sixth Circuit, as well as the Second and Third, erroneously created an exception to this Court's decision in TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976), by holding that under Rule 10b-5 (17 C.F.R. §240.10b-5) preliminary merger discussions with a "white knight" by the target of a hostile tender offer are immaterial as a matter of law and need not be disclosed.

2. Is it inconsistent with TSC v. Northway to hold, as a matter of law, that the target of a hostile tender offer does not violate Rule 10b-5 when it advises its stockholders that "this is an extremely inopportune time to sell the Company and, in any event, that its shareholders would be better served if the Company were to remain independent"

while at the same time concealing its negotiations to sell the Company to a "white knight" at a higher price.

3. Is it possible to hold, consistent with TSC v. Northway, that, as a matter of law, the target of a hostile tender offer has fairly and adequately disclosed to its stockholders its pending negotiations to sell the Company to a "white knight" at a higher price by stating only that: "...the Board considered and reviewed the feasibiity and desirability of exploring and investigating certain types of possible transactions, including ... the acquisition of ... the entire Company ... by another company..."*/

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*/ The full text of the paragraph is set forth at page 8 of the decision of the Sixth Circuit, (App. 8a), and at p. 3-4, infra.

RULE 21(b) STATEMENT

The parties to this case are Petitioner Irving Starkman, M.D., Trustee of the Irving Starkman, M.D., S.C. Defined Benefit Pension Fund and Trust, and Respondents Marathon Oil Company, an Ohio corporation, H. D. Hoopman, C. H. Barre, V. G. Beghnini, H. H. Hering, and W. E. Swales.

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OPINIONS BELOW

The opinion of the Court of Appeals of the Sixth Circuit, dated September 13, 1985, is reported at 772 F.2d 231 and is set forth in the Appendix at App. 1a. The district court opinion, dated February 8 1984, is unreported, and is set forth at App. 24a.

JURISDICTION

On September 13, 1985 the Sixth Circuit entered judgment affirming the district court's judgment against petitioner. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 10(b)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. §78(j)(b)

Rule 10b-5

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commere, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 140.10b-5

STATEMENT OF THE CASE

Petitioner was a stockholder of Marathon Oil Company on October 30, 1981. On that day Mobil Corporation announced its hostile tender offer to purchase up to 68% of Marathon's shares for $85 per share in cash. On October 29 Marathon's closing price on the New York Stock Exchange was $63.75 per share.

On October 31, 1981 Marathon's board of directors met in emergency session and unanimously determined that Mobil's offer was grossly inadequate and approved a vigorous campaign to persuade Marathon stockholders not to tender to Mobil, and to simultaneously seek a "white knight".

At the meeting the directors were presented with an internally prepared valuation report (the Strong report) which indicated a range of value of

Marathon shares between $276 and $323 per share. The report had been prepared as a selling document in the event of a tender offer for Marathon at an inadequate price. The directors were also given an oral valuation report by First Boston Corporation (the First Boston report), Marathon's investment banker, indicating a range of value between $188 and $225 per share. First Boston's written report was delivered to the board on November 5, 1981. It was also to serve as a selling document in the event of an inadequate tender offer.

On November 2, Marathon's president wrote to its stockholders advising rejection of the Mobil offer as grossly inadequate. The letter stated that litigation had been instituted under the antitrust laws and advised that because of major antitrust and other public policy issues, successful

completion of the Mobil offer was highly problematical. The letter enclosed a copy of Marathon's Schedule 14D-9 dated November 2, 1981 which had been filed with the Securities and Exchange Commission.*/ The Schedule 14D-9, in Item 4(b)(iv), at page 3 stated:

> "The Board of Directors also considered current adverse economic, monetary and market conditions. Based upon these and other factors, the Board of Directors believes that this is an extremely inopportune time to sell the Company and, in any event, that its shareholders would be better served if the Company were to remain independent."

The schedule also stated in Item 7(a), at page 7:

> "Item 7. Certain Negotiations and Transactions by the Subject Company

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*/ The Sixth Circuit incorrectly stated that the Schedule 14D-9 was mailed to Marathon shareholders on November 12 (App. 7a.)

(a) At a meeting of the Board of Directors held on October 31, 1981, the Board considered and reviewed the feasibility and desirability of exploring and investigating certain types of possible transactions, including, without limitation, repurchase of Company Common Shares, the public or private sale of equity or other securities of the Company, a business combination between the Company and another company, the acquisition of a significant interest in or the entire Company or of one or more of its significant business segments by another company, a joint venture between the Company and one or more other companies, the acquisition by the Company of all or part of the business of another company, a complete or partial liquidation of the Company or the declaration of an extraordinary dividend. After considerable discussion, the Board resolved that it was desirable and in the best interests of the Company and its shareholders to explore and investigate, with the assistance and advice of First Boston, such transactions, although the Board noted that the initiation or continuation of such activities may be dependent upon Mobil's future actions with respect to the Mobil Offer. There can be no assurance that these activities will result in any transaction being recommended to the Board of

> Directors or that any transaction which is recommended will be authorized or consummated. The effectuation of any transaction of the type referred to in this Item 7(a) may have an impact on the Mobil Offer."

Marathon contacted approximately 35 companies in an effort to find a buyer who would top Mobil's offer. On November 10, 1981 Marathon began negotiations with U. S. Steel for the acquisition of Marathon at a price higher than Mobil's offer. The Strong and First Boston reports were given to U. S. Steel on condition that they be kept confidential. On November 12, at U. S. Steel's request, Marathon delivered its 5-year earnings forecasts and cash flow projections.

On November 11, 1981, Marathon issued a press release which stated: "We plan to do everything possible to defeat [the Mobil] offer. We are determined to remain independent." On November 12,

1981 Marathon's president wrote to its shareholders again urging rejection of Mobil's offer. The letter stated that Mobil was considering a number of alternative courses of action including "a business combination with another company." It further stated, "We are convinced that you and our other shareholders would be well served if Marathon remains independent." Neither the letter nor the press release mentioned the negotiations with U.S. Steel or the contacts with approximately 35 companies in an effort to find a buyer to top Mobil's bid.

Between November 2 and November 18, 1981 Marathon filed ten amendments to its Schedule 14D-9. None of these amendments mentioned the negotiations with U. S. Steel or the company's efforts to find a white knight to top Mobil's bid.

On November 3, 1981, immediately after Mobil's offer, the price of Marathon's stock rose to $90 per share. By November 18, 1981 the price had declined to $78 per share. On that day plaintiff sold his shares on the open market. On that same day Marathon and U. S. Steel reached agreement for a tender offer for 51% of Marathon's shares at $125 per share in cash to be followed by a merger in which each remaining share of Marathon would be acquired for a $100, 12-year 12-1/2% note. The blended price in this two-tier acquisition of Marathon was approximately $106 per share. On November 19 the agreement with U.S. Steel was publicly announced. On that day the closing price of Marathon shares was $104.00 per share.

Plaintiff's complaint*/ alleging concealment of Marathon's premerger activities, the Strong and First Boston reports and the negotiations with U.S. Steel, and demanding a jury trial, was dismissed by the district court on summary judgment. The Sixth Circuit affirmed.

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*/ Plaintiff sought to bring this action as a class action. His motion for class certification was denied by the district court. Although plaintiff's amended notice of appeal sought review of this order, the Sixth Circuit stated that "this issue is not before us on appeal." (App. 2a).

REASONS FOR GRANTING THE WRIT

I. THE SIXTH, SECOND AND THIRD CIRCUITS HAVE CREATED AN EXCEPTION TO THIS COURT'S DECISION IN TSC INDUSTRIES v. NORTHWAY, INC. THIS EXCEPTION IS WITHOUT PRECEDENT AND SO NARROWLY LIMITS THE APPLICATION OF TSC AS TO MAKE IT INAPPLICABLE TO TENDER OFFERS, A GROWING PHENOMENON IN THE PUBLIC SECURITIES MARKET.

TSC was before this Court to consider the definition of a material fact under the proxy rules promulgated by the S.E.C. (17 C.F.R. § 240.14(a)-9), and the appropriateness of resolving the question of materiality by summary judgment. 426 U.S. at 440.

The Court defined a fact as material

> "If there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote * * * there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor

> as having significantly altered the 'total mix' of information made available." (426 U.S. at 449)

The lower court here, as well as other courts, adopted this definition in Rule 10b-5 cases. (App. 12a-13a.)

On the summary judgment question the Court held:

> "In considering whether summary judgment on the issue [of materiality] is appropriate, we must bear in mind that the underlying objective facts, which will often be free from dispute, are merely the starting point for the ultimate determination of materiality. The determination requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Only if the established omissions are 'so obviously important to an investor, that reasonable minds cannot differ on the question of materiality' is the ultimate issue of materiality appropriately resolved 'as a matter of law' by summary judgment." 426 U.S. at 450-451.

Six years after TSC the Third Circuit affirmed a summary judgment for defendants in a Rule 10b-5 case, holding that preliminary merger discussions between the issuer and a friendly suitor were immaterial as a matter of law and did not have to be disclosed to the issuer's stockholders. Staffin v. Greenberg, 672 F.2d 1196, 1205-1206 (1982). The court stated that at least eight other courts also had so held. (Id.) The rationale of Staffin was that disclosure of preliminary merger negotiations "may itself be misleading." Id. at 1206. The court sought to protect investors who might buy stock on the basis of disclosure of preliminary merger discussions and who might be left "holding the bag" if the merger did not occur. Id. at 1207. It also sought to protect the offeror who otherwise might have to pay a higher price. (Id. at 1206.) Thus

the definition of a material fact, and determination of the duty of disclosure, depended upo[illegible] result would produce "the greatest good for the greatest number". Id.

Staffin recognized TSC's "materiality" definition and its "reasonable minds" test and applied them to other facts in the case. (Id. at 1204-1205.) But neither the definition nor the test was mentioned or applied with respect to disclosure of preliminary merger discussions.

One year later, the Second Circuit decided Reiss v. Pan American World Airways, Inc., 711 F.2d 11 (1983). Reiss also affirmed a summary judgment for defendant in a Rule 10b-5 case where the defendant issuer failed to disclose preliminary merger discussions to its

securities holders. The court, citing Staffin, expressed the view that:

> "[i]t does not serve the underlying purposes of the securities acts to compel disclosure of merger negotiations in the not unusual circumstances before us." 711 at 14.

As in Staffin, the court concluded that:

> "[d]isclosure may in fact be more misleading than secrecy so far as investment decisions are concerned." Id.

Reiss did not mention TSC nor did it apply either its "materiality" definition or "reasonable minds" test.

A year after Reiss, the Third Circuit decided Greenfield v Heublein, Inc., 742 F.2d 751 (1984). Here, too, the court affirmed a summary judgment for defendants, holding that the preliminary merger discussions were immaterial as a matter of law; disclosure was required only when an agreement in principle had

been reached. 742 F.2d at 756.*/ The court relied on Staffin and adopted its rationale, i.e., that disclosure of preliminary merger discussions may by misleading to shareholders. Id. The court did not mention TSC, nor did it apply its "materiality" or "reasonable minds" tests.

Greenfield differed from Staffin and Reiss in two respects: (i) the defendant-issuer was fending off a hostile takeover attempt while conducting negotiations with a white knight; and (ii) the issuer had made a public statement denying knowledge of any reason for the high trading activity of the issuer's

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*/ The SEC has expressed the opinion that Greenfield was wrongly decided. In re Carnation Co., Sec. Act. Rel. No. 22214, (July 8, 1985)(1984-1985) Fed.Sec.L.Rep. (CCH) ¶ 83,801.

stock. The Third Circuit affirmed the district court's finding that the statement was literally true and therefore, as a matter of law, was not false, inaccurate or misleading. (Id. at 758-759). In so holding, the court made no mention of TSC's teaching that assessment of the inferences a reasonable shareholder would draw from the underlying objective facts was peculiarly for the trier of fact. Nor did the court mention TSC's "reasonable minds" test.

The present case is the latest progeny of Staffin. It further refines the rule in Staffin, Reiss and Greenfield to hold that, so long as merger or acquisition discussions are preliminary, "general disclosure of the fact that such alternatives are being considered will suffice to adequately inform shareholders...." (App. 21a.) Authority for this

proposition was said to be found in 17 CFR 240.14d-101 which requires the filing of a Schedule 14D-9 by a target company. But that rule says nothing at all about "alternatives ... being considered". Rather, it requires the target to state:

> "...whether or not any negotiation is being undertaken or is underway by the subject company in response to the tender offer which relates to or would result in:
>
> (1) An extraordinary transaction such as a merger or reorganization, involving the subject company; ...
>
> * * *
>
> Instruction: If no agreement in principle has yet been reached, the possible terms of any transaction or the parties thereto need not be disclosed if in the opinion of the Board of Directors of the subject company such disclosure would jeopardize continuation of such negotiations. In such event, disclosure that negotiations are being undertaken or are underway and are in the preliminary stages would be sufficient."

Applying its newly-refined rule to the facts, the Sixth Circuit found that, as a matter of law, the disclosures in Item 7 of Marathon's Schedule 14D-9 adequately informed Marathon's shareholders of the company's vigorous campaign to seek a white knight and of the negotiations with U. S. Steel. (App. 22a.)

The lower court also found, as a matter of law, that Marathon's statements that it was "an extremely inopportune time to sell the company and, in any event, that its shareholders would be better served if the company were to remain independent", were not misleading "when read in their full context". (App. 22a.)

In excusing disclosure of the fact that Marathon was engaged in preliminary merger discussions and sanctioning only "general disclosure of the fact that

such alternatives are being considered", the court adopted Staffin's rationale that disclosure of preliminary discussions could very easily mislead shareholders. (App. 22a.)

Although the Sixth Circuit recognized TSC's definition of materiality earlier in its opinion (App. 12a), it did not apply that definition in deciding that preliminary merger discussions were immaterial as a matter of law. In ruling that the disclosures made were adequate as a matter of law, the court did not mention the teaching of TSC that the assessments of the inferences a reasonable shareholder would draw from a given set of facts and the significance of those inferences to him are peculiarly ones for the trier of fact.

The doctrine first announced in Staffin, and developed through Reiss,

Greenfield and the present case, is wholly without precedent and cannot be reconciled with TSC. Its basic premise that "disclosure of preliminary merger discussions would, by and large, do more harm than good to shareholders and the values embodied in the antifraud provisions of the Act" (672 F.2d at 1206) certainly does not rest on the authority of this Court. To the contrary, TSC stated that one of the purposes of the antifraud provisions was "to ensure disclosures by corporate management in order to enable the shareholders to make an informed decision." 426 U.S. at 448.

Staffin identified two discrete types of investor who might be disadvantaged if preliminary merger discussions were disclosed. The offeror, who might be required to pay a higher price for the target company as the market price rose

toward the expected tender price (672 F.2d at 1206); and the speculator who might buy in a rising market and suffer a loss if the merger does not occur. (Id. at 1207). In the present case, the court below feared the same consequences. (App. 23a.) But, neither of these consequences would be caused by fraud. Both would result from normal market reaction to truthful disclosure of material facts. In each case the price movement would be caused by reasonable investment decisions made by informed investors. It is not and never has been the purpose of the federal securities laws to protect investors from the consequences of the truth.

On the other hand, concealment of preliminary merger discussions can work a real fraud on the stockholders of a target company, as is demonstrated by

the present case. Marathon stockholders knew that Mobil was offering $85 per share. They also knew that Marathon was strenuously resisting Mobil's bid and was "determined to stay independent". The investing public obviously accepted Marathon's position at face value, since the price of Marathon's stock, after running up to $90 per share in response to Mobil's bid, thereafter declined to $78 the day before announcement of the U. S. Steel agreement. The day of the announcement the price jumped to $104 per share. The market was completely fooled by concealment both of Marathon's efforts to find a white knight and of its negotiations with U. S. Steel. Plaintiff Starkman and all other Marathon stockholders who sold in the open market in reliance on Marathon's declaration of independence, and in ignorance of Marathon's preliminary merger discussions, were deceived.

The notion that disclosure of preliminary merger discussions does more harm than good is ill-conceived and unsupported by any empirical data. Nothing in the federal securities laws, or in any decision of this Court, sanctions a rule which, stripped to its essence, says to the investing public, "what you don't know won't hurt you". The Staffin doctrine, which the Sixth Circuit adopted and followed in this case, was not designed to protect investors from fraud. Rather, it assumes that a federal court can divine what investment decision an investor will make if particular material information is disclosed, and can further divine likely price movements after such disclosure. Based on such insight, the Court can count the losers and the winners; if the losers are in the majority, the Court can conclude that the information should not

be disclosed. Hence, Staffin's calculus of the "greatest good for the greatest number." (Id. at 1207). Such a determination would not rest on the materiality of the information nor on any justified conclusion that the disclosure would be misleading. It rests simply and wholly on the determination to protect investors from what the court would perceive to be their own folly. Hence, Staffin's concern for speculators "left 'holding the bag'," if the merger does not occur. (Id.)

Even worse, what Staffin and its progeny, including the present case, represent is a legislative judgment that the interests of tender offerors and speculators - perfect strangers to the target company - are entitled to protection under the federal securities laws in derogation of the interests of the

target's own stockholders. This normative judgment is more appropriate for Congress than for the courts. In any event, it is completely at odds with this Court's decision in TSC, both as to the definition of materiality and the appropriateness of summary judgment on that issue.

II. THE EXCEPTION CREATED BY THE SIXTH, SECOND AND THIRD CIRCUITS COMPLETELY REJECTS TSC'S HOLDING THAT THE QUESTION OF MATERIALITY IS PECULIARLY FOR THE TRIER OF FACT UNLESS REASONABLE MINDS CANNOT DIFFER

The lower court's summary determination that the stockholders of Marathon were fairly and adequately informed of the company's premerger discussions is a complete rejection of TSC's "reasonable minds" test.

The court summarily concluded that the language in Item 7(a) of Marathon's Schedule 14D-9 contained such disclosure. However, in order to be consistent with TSC, the court also would have had to determine what inferences a reasonable shareholder would have drawn from this language, assess the significance to him of these inferences, and then find that reasonable minds could not differ with the court's own conclusion. 426 U.S. at 450-451.

But the opinion mentions no such inferences, let alone makes any assessment thereof, and makes no reference to the "reasonable minds" test. Contrary to TSC's admonition that inferences and assessments are peculiarly for the trier of fact, the district court usurped the jury's exclusive prerogative and became

the trier of fact on these questions. The Sixth Circuit did the same.

The only fair conclusion from the Sixth Circuit's finding that fair and adequate disclosure of Marathon's plans was made to its shareholders is that a lower standard of disclosure is imposed on targets of hostile tender offers than is otherwise required under Rule 10b-5. The higher standards announced in TSC do not apply in such cases. As long as language such as appears in Item 7(a) of Marathon's Schedule 14D-9 even remotely touches on the possibility of negotiations, the target is excused from disclosure of the fact that actual negotiations are proceeding with another suitor at a higher price. No jury could draw any inference from such language other than the one drawn by the Sixth Circuit in this case.

Similarly, in the Sixth Circuit's view, no inferences may be drawn from Marathon's stated belief that it was an extremely inopportune time to sell the company, or from its repeated declaration that the company should remain independent. Such statements, even if inconsistent with the target's concealed activities in seeking a white knight, are to be disregarded if made in response to a hostile tender offer. TSC's instruction that any inferences to be drawn from Marathon's statements were peculiarly ones for determination by the trier of fact (a jury here) was either disregarded by the Sixth Circuit or deemed, sub silentio, to be inapplicable.

Given the increasing frequency of tender offers and their impact on the investing public, lowering the standard of disclosure imposed by Rule 10b-5 on

target companies would seem to be inappropriate. If the lower courts are to be free of the strictures of TSC v. Northway in tender offer cases, such freedom should be only as granted by this Court.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Court of Appeals for the Sixth Circuit.

Respectfully submitted

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APPENDIX

RECOMMENDED FOR FULL TEXT PUBLICATION
See, Sixth Circuit Rule 24

No. 84-3215

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

IRVING STARKMAN, M.D., Trustee of the Irving Starkman, M.D., S.C. Defined Benefit Pension Fund and Trust, on behalf of himself and all others similarly situated,
Plaintiff-Appellant,

v.

MARATHON OIL COMPANY, an Ohio corporation, H. D. HOOPMAN, C. H. BARRE, V. G. BEGHINI, H. H. HERING, and W. E. SWALES,
Defendants-Appellees.

ON APPEAL from the United States District Court for the Southern District of Ohio.

Decided and Filed September 13, 1985

Before: MERRITT and KENNEDY, Circuit Judges; and PECK, Senior Circuit Judge.

MERRITT, Circuit Judge. Like *Radol* v. *Thomas*, No. 83-3598 (6th Cir. 1985), this action arises out of U.S. Steel's November, 1981 acquisition and eventual merger with Mara-

thon Oil Company. The plaintiff here, Irving Starkman, was a Marathon shareholder until selling his shares on the open market for $78 per share on November 18, 1981, the day before U.S. Steel's tender offer for 51% of Marathon's outstanding shares at $125 per share was announced.[1] On October 31, 1981, Mobil Oil had initiated its takeover bid for Marathon, a bid which Marathon actively resisted by urging its rejection by Marathon shareholders and by seeking and eventually finding a "white knight" or alternative, friendly merger partner-tender offeror, U.S. Steel. Starkman claims that Marathon's board violated Rule 10b-5 and its fiduciary duty to him as a Marathon shareholder by failing to disclose various items of "soft" information – information of less certainty than hard facts – in its public statements to shareholders during the period after Mobil's hostile tender offer and prior to Steel's friendly tender offer. In particular, he says that Marathon should have told shareholders that negotiations were underway with U.S. Steel prior to the consummation of those negotiations in an agreement, and that internal and externally-prepared asset appraisals and five-year earnings and cash flow projections should have been disclosed to shareholders so that they could make a fully informed choice whether to sell their shares or gamble on receiving a higher price in a possible Steel-Marathon merger.

The District Court granted summary judgment for Marathon, finding that these items of soft information had either been sufficiently disclosed or were not required to be disclosed because their nondisclosure did not render materially misleading Marathon's other affirmative public statements. For the reasons stated below, we affirm the judgment of the district Court.

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[1] Although Starkman still styles his case as a class action, the District Court twice denied motions for class determination, and this issue is not before us on appeal.

I. BACKGROUND

We have discussed the background and structure of U.S. Steel's acquisition of Marathon Oil at some length in *Radol* v. *Thomas*, No. 83-3598 (6th Cir. 1985), and our attention here will therefore be focused on the facts which are especially relevant to Starkman's Rule 10b-5 claims.[2]

In the summer of 1981, Marathon was among a number of oil companies considered to be prime takeover targets. In this atmosphere, Marathon's top level management began preparations against a hostile takeover bid. Harold Hoopman, Marathon's president and chief executive officer, instructed the company's vice presidents to compile a catalog of assets. This document, referred to as the "Strong Report" or "internal asset evaluation," estimated the value of Marathon's transportation, refining and marketing assets, its other equipment and structures, and the value of proven, probable, and potential oil reserves as well as exploratory acreage. Hoopman and John Strong, who was responsible for combining materials received from various divisions into the final report, both testified that the Strong report was viewed as a "selling document" which placed optimistic values on Marathon's oil and gas reserves so as to attract the interest of prospective buyers and ensure that Marathon could either ward off an attempt to capture Marathon at a bargain price or obtain the best offer available.

In estimating proven, probable, and potential reserves and exploratory acreage, the Strong Report was based on informa-

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[2] Judge Rubin disposed of this suit on summary judgment after the trial in *Radol* v. *Thomas*. Although very limited discovery was allowed prior to the summary judgment order, Starkman moved to supplement the record on this appeal, with a large amount of evidence taken in *Radol* v. *Thomas*, including the Strong and First Boston reports, Doc. 91, and this motion was unopposed by Marathon and was granted. Doc. 98. All the facts discussed in this section are properly in the record in this appeal as supplemented, but references to their physical location in the *Radol* v. *Thomas* appellate record will be explicitly noted where appropriate. Otherwise, "A" denotes the appendix in this appeal.

tion that was not available to the general public, for example in annual reports, because only the value of proven reserves was normally included in such public documents. The Strong Report defined proven reserves as those actually producing, probable reserves as reserves for properties where some production had been established and additional production was likely, and potential reserves as reserves for properties where production had not yet been established but where geologic evidence supported wildcat drilling.[3] These reserves were valued using a discounted cash flow methodology, under which the present value of oil reserves is calculated by summing risk discounted expected net revenues from the particular field over the life of the field, and then discounted into present value by dividing by an estimated interest rate. This valuation method, a standard procedure for determining the cash value of oil and gas properties, required projections of price and cost conditions prevailing as far as 20 years into the future. For example, the Strong Report assumed that the rate of increase in oil prices would average over 9% per year from 1980-1990.

Using this methodology, the Strong Report valued Marathon's net assets at between $19 billion and $16 billion (depending on which set of interest rates was used to discount back to present value), a per share value of between $323 and $276. The value of oil and gas reserves made up $14 billion of the $19 billion estimate and $11.5 billion of the $16 billion estimate. A similar report using identical methodology was prepared in mid-July 1981 by the investment banking firm of First Boston, which had been hired by Marathon to assist in preparing for potential takeover bids. The First Boston Report was based only upon proven and probable oil reserves and was also intended to be used as a "presentation piece" to avoid a takeover or maximize the price obtained in a take-

[3] These definitions appear at pages 1160-1162 in the Appendix in *Radol* v. *Thomas*.

over. It placed Marathon's value at between $188 and $225 per share.

Some perspective on the values arrived at in the Strong and First Boston reports can be gained from other, publicly available appraisals of Marathon's assets prepared during 1981. The Herold Oil Industry Comparative Appraisal placed Marathon's appraised value at $199 per share, and two other reports by securities analysts said Marathon had an appraised value of between $200 and $210 per share.[4]

Marathon's market value, however, was well below these appraised values. On October 29, 1981, Marathon closed at $63.75 per share. The next day, Mobil Oil announced its tender offer to purchase up to approximately 68% of outstanding Marathon common stock for $85 per share in cash. Mobil proposed to follow the tender offer with a going private or freezeout merger in which the remaining shareholders of Marathon would receive sinking fund debentures worth approximately $85 per share.

On October 31, 1981, Marathon's board of directors met in emergency session and unanimously decided that the Mobil offer was "grossly inadequate" and approved a vigorous campaign to persuade Marathon shareholders not to tender to Mobil, and to simultaneously seek a "white knight." On November 11 and 12, Marathon's Board made public statements to the shareholders recommending rejection of Mobil's bid as "grossly inadequate" and against the best interests of the company. We explore these statements in more detail below, as they are a primary focus of Starkman's claims of inadequate disclosure. However, at the time these statements to shareholders were made, Marathon representatives had already contacted all of the 30 to 35 companies who could possibly undertake an acquisition topping Mobil's bid, and, in particular, had begun negotiations with U.S. Steel on November

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[4] *See Radol* v. *Thomas* appendix at 2585, 2590.

10. The Strong and First Boston reports were given to Steel on that same day, on the condition that they be kept confidential, and on November 12, Marathon's vice president for finance delivered five-year earnings forecasts and cash flow projections to Steel in Pittsburgh.

On November 17, Hoopman and David Roderick, Steel's president, reached agreement on the terms of Steel's purchase of Marathon, and, after Board approval, an agreement was signed on November 18, 1981. Under the terms of the agreement, Steel would make a tender offer for up to 31 million shares (about 51%) of Marathon stock for $125 per share in cash, to be followed by a merger proposal in which each remaining Marathon shareholder would receive one $100 face value, 12 year, 12¾ per cent guaranteed note per share of common stock. On November 19, Steel mailed its tender offer to Marathon shareholders, and Hoopman sent a letter to Marathon shareholders describing the two-stage deal and stating the opinion of Marathon's Board that the agreement was fair to Marathon shareholders. Steel's offer was successful, with over 91% of the outstanding shares tendered, and the second stage freezeout merger was approved by a two-thirds majority of the remaining shareholders in February, 1982.

II. MARATHON'S PUBLIC STATEMENTS AND DISPOSITION BELOW

There are three public statements by Marathon management at issue here. First, Marathon's November 11, 1981, press release, which states, in pertinent part, that:

> Our Board of Directors has determined that Mobil Corporation's unsolicited tender offer is grossly inadequate. The offer is not in the best interests of Marathon Oil or its shareholders. It doesn't reflect current asset values and it doesn't permit the long-term investor the opportunity to participate in the potential values that have been developed.

• • •

> We plan to do everything we possibly can to defeat this offer. We are determined to stay independent.

A. 187.

The next day, as required by Rule 14e-2, 17 C.F.R. § 240. 14e-2 (1984), Marathon mailed a letter to its shareholders stating its position regarding Mobil's tender offer. The letter urged rejection of the offer, stating that Marathon's Board was "convinced that the Mobil offer is grossly inadequate and does not represent the real values of the assets underlying your investment in Marathon." A. 182. The letter described a number of alternative courses of action that were being considered by the Board, including "repurchase of Marathon shares, acquisition of all or part of another company, a business combination with another company, (and) the declaration of an extra ordinary dividend and a complete or partial liquidation of the Company," *id.*, and concluded by again urging rejection of Mobil's attempt to "seize control of Marathon's assets at a fraction of their value," and stating that "[w]e are convinced that you and our other shareholders would be well served if Marathon remains independent." *Id.*

Attached to this letter was a copy of Marathon's Schedule 14D-9, filed pursuant to Rule 14d-9, 17 C.F.R. § 240.14d-9, in which the board informed the SEC that it had recommended rejection of the Mobil offer as "grossly inadequate." Item 4(b)(iv) of Marathon's Schedule 14D-9 listed as a factor supporting this recommendation the board's belief that based on current economic and market factors, "this is an extremely inopportune time to sell the Company and, in any event, that its shareholders would be better served if the Company were to remain independent." A. 92. Item 7 of this same schedule described "Certain Negotiations and Transactions" by Marathon:

> At a meeting of the Board of Directors held on October 31, 1981, the Board considered and reviewed the feasibility and desirability of exploring and investigating certain types of possible transactions, including, without limitation, repurchases of Company Common Shares, the public or private sale of equity or other securities of the Company, a business combination between the Company and another company, the acquisition of a significant interest in or the entire Company or of one or more of its significant business segments by another company, a joint venture between the Company and one or more other companies, the acquisition by the Company of all or part of the business of another Company, a complete or partial liquidation of the Company or the declaration of an extraordinary dividend. After considerable discussion, the Board resolved that it was desirable and in the best interest of the Company and its shareholders to explore and investigate, with the assistance and advice of First Boston, such transactions, although the Board noted that the initiation or continuation of such activities may be dependent upon Mobil's future actions with respect to the Mobil Offer. There can be no assurance that these activities will result in any transaction being recommended to the Board of Directors or that any transaction which is recommended will be authorized or consummated.

A. 96.

Starkman argues that the failure of any of these communications to disclose the Strong and First Boston reports and the five-year earnings and cash flow projections constituted an omission of material facts which rendered these communications materially misleading, and that Marathon not only failed to adequately disclose its search for a white knight and its negotiations with Steel but actually gave the false impression that the Board was endeavoring to preserve Marathon as an independent entity. He argues that the Strong

and First Boston reports, the five-year cash and earnings projections, and the fact of ongoing negotiations with U.S. Steel were all material facts because knowledge of them would have affected a reasonable shareholder's evaluation of the likelihood that Marathon would succeed in negotiating a higher price takeover, and thereby affect such a shareholder's decision to sell his shares. He contends that shareholders were not adequately informed of Marathon management's search for a "white knight" and of the negotiations with Steel, and that failure to disclose more information regarding these negotiations rendered statements suggesting that Marathon might remain independent materially misleading. Similarly, Starkman contends that if he had been told of the Strong and First Boston reports and the five-year earnings and cash flow projections, and also that Marathon management was using these figures in seeking an alternative bidder, then he would have anticipated a much higher bid than he did, and that failure to release this information rendered materially misleading the affirmative statements Marathon did make.

In his brief on this appeal, Starkman has repeatedly mischaracterized the decision of the District Court as holding that none of the information Starkman contends should have been disclosed was material. To understand the District Court's holding in this case, it is important to note at the outset that in *Radol* v. *Thomas*, No. 83-3598 (6th Cir. 1985), the plaintiffs claimed that the same asset appraisals at issue here should have been disclosed by Steel in its tender offer and by Marathon in its statements recommending that shareholders accept Steel's offer. Judge Rubin presided over both the present suit and *Radol*, and in *Radol* he denied the defendant's motion for summary judgment on the issue of whether the asset appraisals should have been disclosed at the time of Steel's tender offer on the ground that the reports were not, as a matter of law, immaterial, and he sent the materiality of these reports to the jury. *See Radol* v. *Thomas*, 556 F. Supp. 586, 594 (S.D. Ohio 1983).

In granting summary judgment for Marathon in the present action, however, Judge Rubin found that the net asset values stated in the Strong and First Boston reports were perfectly consistent with Marathon's repeated public assertion that Mobil's bid was "grossly inadequate" in light of the true value of Marathon's assets, and that disclosure of the reports was not required under Rule 10b-5 because "disclosure of information which is consistent with other statements made is obviously not necessary in order to make those statements not misleading. Such disclosure would simply reinforce, rather than correct or modify, the statements made." A. 16. As to the claim that nondisclosure of the reports rendered misleading Marathon's statements that the best result would be for the company to remain independent, the District Court said that these statements were not misleading when placed in the context of the repeated assertion that Mobil's offer was "grossly inadequate" and that alternatives including merger into another company were under consideration. A. 17.

The District Court summarily disposed of the claim that the five-year earnings and cash flow projections should have been disclosed, concluding that disclosure of such information is simply not required under *Marsh* v. *Armada Corp.*, 533 F.2d 978, 986-87 (6th Cir. 1976), *cert. denied*, 419 U.S. 830 (1974), and *Arber* v. *Essex Wire Corp.*, 490 F.2d 414, 421 (6th Cir. 1974), *cert. denied*, 430 U.S. 954 (1977). A. 18.

As to disclosure of the negotiations with Steel, the District Court cited *Reiss* v. *Pan American World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983), and *Staffin* v. *Greenberg*, 672 F.2d 1196, 1206 (3d Cir. 1982), in ruling that Marathon's 14D-9 disclosure that the acquisition of all or part of another company, or merger with another company, was being considered as an alternative to the Mobil offer sufficed to meet whatever disclosure obligation may have existed. A. 19-20.

III. DISCUSSION

A. Introduction

Pursuant to Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), which prohibits the use of any "manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe," "in connection with the purchase or sale of any security," the SEC promulgated Rule 10b-5, which provides in pertinent part that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
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> • • •
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . .

17 C.F.R. § 240.10b-5 (1984).

Aptly described as a "judicial oak which has grown from little more than a legislative acorn," *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 737 (1975), Rule 10b-5 has been the source of a wide-ranging federal common law of securities fraud, clearly applicable to the tender offer context, provided that, as here, there has been a purchase or sale of a security. *See* 3 L. Loss, *Securities Regulation* 1445 (2d ed. 1961).

Despite occasional suggestions by commentators, *see, e.g.*, Bauman, *Rule 10b-5 and the Corporation's Affirmative Duty to Disclose*, 67 Geo. L.J. 935 (1979), and the courts, *Zweig* v. *Hearst Corp.*, 594 F.2d 1261, 1266 (9th Cir. 1979), that

Rule 10b-5 imposes an affirmative obligation on the corporation to disclose all material information regardless of whether the corporation has made any other statements, the established view is that a "duty to speak" must exist before the disclosure of material facts is required under Rule 10b-5. *See Flynn* v. *Bass Brothers Enterprises, Inc.*, 744 F.2d 978, 984 (3d Cir. 1984) (citing *Chiarella* v. *United States*, 445 U.S. 222, 235 (1980); *Staffin* v. *Greenberg*, 672 F.2d 1196, 1202 (3d Cir. 1982)). Provided that such a duty to speak exists, a further limitation on the duty to disclose is imposed by the requirement that only misstatements of material facts and omissions of material facts necessary to make other required statements not misleading are prohibited by Rule 10b-5. The Supreme Court's definition of "material" in the context of an alleged violation of Rule 14a-9, governing disclosure requirements in proxy statements, has been adopted for cases involving Rule 10b-5 in the tender offer context. *Flynn* v. *Bass Brothers Enterprises*, 744 F.2d at 985; *Staffin* v. *Greenberg*, 672 F.2d at 1205; *Panter* v. *Marshall Field & Co.*, 646 F.2d 271, 282 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). That definition reads as follows:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. This standard is fully consistent with [Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970)] general description of materiality as a requirement that "the defect have a significant propensity to affect the voting process." It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have

> been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

TSC Industries, Inc. v. *Northway, Inc.*, 426 U.S. 438, 449 (1976).

In structuring the disclosure duties of a tender offer target, we begin therefore with the basic proposition that only material facts — those substantially likely to affect the deliberations of the reasonable shareholder — must be disclosed, and then *only* if the nondisclosure of the particular material facts would make misleading the affirmative statements otherwise required by the federal securities laws and SEC regulations.

Our adherence to this basic proposition ensures that target management's disclosure obligations will strike the correct balance between the competing costs and benefits of disclosure. The benefits of disclosure in ensuring that shareholders who are suddenly faced with a tender offer will not be forced to respond without adequate information are clearly recognized in Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e), which somewhat broadens the reach of Rule 10b-5 to statements made "in connection with any tender offer" and which provides the statutory authority for SEC rules imposing affirmative disclosure obligations on tender offer targets.[5] On the other hand, tender offers remain essentially contests in which participants on both sides act under the "stresses of the marketplace," and "[p]robably there will no more be a perfect tender offer than a perfect trial." *Electronic Specialty Co.* v. *International Controls Corp.*, 409 F.2d 937,

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[5] Section 14(e) provides, in part, that:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer. . . .

948 (2d Cir. 1969) (Friendly, J.). Under these conditions, imposing an "unrealistic requirement of laboratory conditions," *id.*, would place target management under the highly unpredictable threat of huge liability for the failure to disclose, perhaps inducing the disclosure of mountains of documents and hourly reports on negotiations with potential tender offerors, a deluge of information which would be more likely to confuse than guide the reasonable lay shareholder and which could interfere with the negotiation of a higher tender offer and actually reduce the likelihood that a shareholder will benefit from a successful tender offer at a premium over the market. It is with these competing considerations in mind that we turn to the particular disclosure claims made here.

B. Asset Appraisals and Earnings Projections

We first address Starkman's contention that Marathon should have disclosed the Strong and First Boston reports and the five-year earnings projections and forecasts given to Steel. Under the authority of Section 14(e) of the Williams Act, the SEC requires a tender offer target to make two affirmative statements regarding an offer. First, Rule 14e-2 requires that the target company mail or publish a statement to its shareholders within 10 days of the tender offer stating its position (or stating it cannot take a position) and giving reasons for the position. Under Rule 14d-9, a Schedule 14D-9 must be filed with the SEC "as soon as practicable" after the recommendation letter is sent to shareholders. The information to be included in the Schedule 14D-9 is described in 17 C.F.R. § 14d-101. Significantly, although Item 4 of the Schedule 14D-9 is to contain a statement of the reasons for the target's position with respect to the offer, and Item 8 requires disclosure of any additional information as "may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading" neither the shareholder recommendation letter nor the Sched-

ule 14D-9 must contain internal asset appraisals, appraisals done by outside consultants such as First Boston, or earnings and cash flow projections.

Since there is no SEC rule specifically requiring the disclosure of this information, we must determine whether Rule 10b-5 requires its disclosure as material information, the nondisclosure of which would render misleading other statements made by Marathon. The starting point in this analysis is the underlying regulatory policy toward disclosure of such information, since regulatory rules reflect careful study of general conditions prevailing in the securities marketplace and provide guidelines upon which corporate officers and directors are entitled to rely.

The SEC's policy toward the inclusion of appraised asset valuations, projections and other "soft" information in proxy materials, tender offers and other disclosure documents has undergone a gradual evolution toward *allowing* the inclusion of such information in some special contexts, provided that the assumptions and hypotheses underlying predicted values are also disclosed.

In 1976, future earnings projections were deleted from a list of examples of potentially misleading disclosures in proxy statements in the note which followed Rule 14a-9. *See* Securities Act Release No. 5699, *reprinted in* [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80, 461 (1976). And, effective July 30, 1979, the SEC adopted a "safe harbor" rule for projections, under which a statement containing a projection of revenues and earnings would not be considered to be a materially misleading misstatement or omission for purposes of liability under the federal securities laws provided the statement was prepared with a reasonable basis and was disclosed in good faith. *See* Securities Act Release No. 6084 *reprinted in* [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,117, at 81,939 (June 25, 1979).

With respect to asset appraisals, Rule 13e-3, 17 C.F.R. § 240.13e-3, requires disclosure of the information called for

by Items 7, 8, and 9 of Schedule 13E-3, 17 C.F.R. § 240.13e-100, in the context of freezeout mergers. Item 8 of Schedule 13E-3 requires disclosure of factors important in determining the fairness of such a transaction to unaffiliated shareholders, and these factors include liquidation value; Item 9 of that same schedule says that a summary of any outside appraisal must be furnished, with the summary including a discussion of the procedures and methods of arriving at the findings and recommendations of the appraisal. However, a 1979 SEC-proposed amendment under which an issuer would have to disclose any projection given to an appraisal furnisher was never adopted, *see* 2 Fed. Sec. L. Rep. (CCH) ¶ 23-706, at 17,245-21 through 21A, and, even more importantly, in *Radol* v. *Thomas*, No. 83-3598, (6th Cir. 1985), we have rejected the positioin that SEC rules regarding freezeout mergers and proxies should determine the disclosure obligations of target management in the first stage of a two-tier tender offer.[6]

Finally, we note that until March, 1982, Regulation S-K, the source for disclosure obligations in annual reports, registration documents and other documents that must be filed with the SEC, provided in Instruction 2 to Item 2(b) that estimates of probable or possible oil and gas reserves should not be disclosed in any document publicly filed with the SEC. *See* Securities Act Release No. 6008, *reprinted in* [1978

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[6] In addition, while the note to Rule 14a-9 lists "predictions as to specific future market values" as a potentially misleading proxy statement disclosure, the SEC in 1980 authorized disclosure of good faith appraisals made on a reasonable basis in proxy contests in which a principal issue is the disposition of the issuer's assets, provided that the valuations are accompanied by "disclosure which facilitates shareholders' understanding of the basis for and limitations on the projected realizable values." Exchange Act Release No. 34-16833, *reprinted in* 3 Fed. Sec. L. Rep. (CCH) ¶ 24,117 (May 23, 1980). This same release cautioned, however, that where "valuations are so qualified and subject to material limitations and contingencies, inclusion in proxy soliciting material of specific realizable values may be unreasonable." 3 Fed. Sec. L. Rep. (CCH) at 17, 621-13.

Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81, 768, at 81,104 (Dec. 19, 1978). The underlying reason was that "estimates of probable or possible reserves and any value thereof are not sufficiently reliable to be included . . . and may be misleading to investors." *Id.* In March, 1982, well after Steel's tender offer, Item 102 of Regulation S-K was amended to *allow* disclosure of "estimated" as well as proved reserves where such estimates have previously been provided to a person who is offering to acquire or merge with the subject company, *see* Securities Act Release No. 6383, *reprinted in* [1937-1982 Accounting Series Release Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 72,328, at 63,003 (March 3, 1982). The Strong and First Boston reports contain estimates of probable and possible reserves, and the disclosure of this information was actually prohibited at the time of Steel's tender offer, and only *permitted* since that time.

Thus, at the time of Steel's tender offer, the SEC did not require disclosure of earnings projections in any context, and required disclosure of asset appraisals, in summary form, only in the special context of freeze-out mergers, which differs markedly from the setting of a first-stage tender offer. Although the SEC allowed disclosure of projections, provided they were prepared on a "reasonable basis" and in "good faith," and also allowed disclosure of similarly supported asset appraisals in some proxy contests, it forbade the disclosure of estimates of probable and potential oil and gas reserves, a major component of the Strong and First Boston appraisals. Absent compelling authority to the contrary, we are reluctant to impose liability on Marathon for failing to disclose asset appraisals based on hypothetical valuations which the SEC did not then permit to be disclosed in most contexts, particularly since Section 23(a) of the Securities and Exchange Act, 15 U.S.C. § 78w(a)(1) provides that no liability under the federal securities laws shall be imposed for "any act done or omitted in good faith conformity with a rule, regulation, or order of the Commission." *See Gerstle*

v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1292-94 (2d Cir. 1973) (refusing, per Friendly, J., to impose liability on the basis of an ex-post modification in SEC policy for non-disclosure in 1963 merger proxy statement of asset appraisals when it was an "article of faith" among securities lawyers in 1963 that such appraisals could not be included in a proxy statement.)

Rather than suggesting a duty to disclose the Strong and First Boston reports, however, our cases firmly establish the rule that soft information such as asset appraisals and projections must be disclosed only if the reported values are virtually as certain as hard facts.

This Court has recently held that a target's failure to disclose an appraisal based on five-year cash flow and earnings projections and intended to be used as a selling document in ongoing merger discussions did not violate Rule 10b-5. *Biechele* v. *Cedar Point, Inc.*, 747 F.2d 209 (6th Cir. 1984). Chief Judge Lively's opinion for the court reasoned that the report was a "selling document" which "contained projections and speculative assumptions which were little more than predictions of future business success." and valuations based on the replacement cost of assets which could be misleading to shareholders, since they varied from balance sheet information prepared according to accepted accounting principles. *Id.* at 216. Similarly, in *James* v. *Gerber Products Co.*, 587 F.2d 324, 327 (6th Cir. 1978), we held that the failure to disclose interim earnings reports in connection with a shareholder's sale of stock back to the issuing company did not violate Rule 10b-5, because "such sales figures, projections, forecasts and the like only rise to the level of materiality when they can be calculated with substantial certainty." And in *Arber* v. *Essex Wire Corp.*, 490 F.2d 414, 421 (6th Cir.), *cert. denied*, 419 U.S. 830 (1974), another case involving a corporate stock repurchase, then Judge McCree said that while a fixed plan of future corporate activity might, under some circumstances, be viewed as a material

fact, Section 10(b) and Rule 10b-5 did not require a corporate insider to disclose his educated guesses or predictions, and "[i]n short, the law mandates disclosure only of existing material facts. It does not require an insider to volunteer any economic forecast." *See also Marsh* v. *Armada Corp.*, 533 F.2d 978, 987 (6th Cir. 1976), *cert. denied*, 430 U.S. 954 (1977) (failure to make a projection of future earnings in freeze-out merger proxy statement not actionable under Rule 10b-5).

Our cases fully support a rule under which a tender offer target must disclose projections and asset appraisals based upon predictions regarding future economic and corporate events only if the predictions underlying the appraisal or projection are substantially certain to hold. An example is when the predictions in fact state a fixed plan of corporate activity. If a target chooses to disclose projections and appraisals which do not rise to this level of certainty, then it must also inform the shareholders as to the basis for and limitations on the projected realizable values.[7]

The Third Circuit has enunciated a different test, under which "courts should ascertain the duty to disclose asset valuations and other soft information on a case by case basis, by weighing the potential aid such information will give the shareholder against the potential harm, such as undue reliance, if the information is released with a proper cautionary note." *Flynn* v. *Bass Brothers Enterprises*, 744 F.2d at 988. The court listed several factors the courts have considered in determining the reliability of soft information, including the

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[7] We note that this rule is fully consistent with the recent statement by the SEC Advisory Committee on Tender Offers that "current disclosures of projections and valuations given to a bidder by a target company are essentially meaningless and can be misleading without disclosure of the underlying assumptions," and with that Committee's recommendation that "[w]here the bidder discloses projections or asset valuations to target company shareholders, it must include disclosure of the principal supporting assumptions provided to the bidder by the target." *See* SEC Advisory Committee on Tender Offers, Report of Recommendations, at 29 (July 8, 1983).

qualifications of those who prepared the appraisal, the degree of certainty of the data on which it was based, and the purpose for which it was prepared. 744 F.2d at 986, 988 (compiling cases); *see also Panter* v. *Marshall Field*, 646 F.2d at 292-93.

By its very nature, however, this sort of judicial cost-benefit analysis is uncertain and unpredictable, and it moreover neglects the role of the market in providing shareholders with information regarding the target's value through competing tender offers. Our approach, which focuses on the certainty of the data underlying the appraisal or projection, ensures that the target company's shareholders will receive all essentially factual information, while preserving the target's discretion to disclose more uncertain information without the threat of liability, provided appropriate qualifications and explanations are made.

Under this standard, Marathon plainly had no duty to disclose the Strong and First Boston reports, because these reports contained estimates of the value of probable, potential and unexplored oil and gas reserves which were based on highly speculative assumptions regarding the path of oil and gas prices, recovery rates and the like over a period of thirty to fifty years. Disclosure of such estimated values could well have been misleading without an accompanying mountain of data and explanations. There is no reported case actually holding that disclosure of appraised values of oil and gas reserves is required, and several which agree with our decision that such disclosure is not required.[8]

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[8] *See, e.g., Sunray* v. *DX Oil Co.* v. *Helmerich & Payne, Inc.*, 398 F.2d 447, 450-51 (10th Cir. 1968) ("any statement concerning oil reserves other than in the category of 'proved' could certainly be misleading to any investor other than one who is an expert in the industry"); *Caspary* v. *Louisiana Land and Exploration Co.*, 579 F. Supp. 1105 (S.D.N.Y. 1983), *aff'd*, 725 F.2d 189 (2d Cir. 1984) (no duty to disclose internal projections regarding oil recovery rates and exploration costs); *Bradshaw* v. *Jenkins*, [1983-84 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 99,719 (W.D. Wash. March 9, 1984) (no duty to disclose consultant's estimated value of energy loan portfolio).

Similarly, Marathon had no duty to disclose the five-year earnings and cash flow projections given to Steel and First Boston. This information does not rise to the level of substantial certainty triggering a duty to disclose. *Biechele* v. *Cedar Point; James* v. *Gerber Products Corp.*, both *supra*.

Further, disclosure of the asset appraisals and earnings and cash flow projections was not required in order to ensure that other statements in Marathon's 14D-9 and in its letter recommending rejection of Mobil's bid were not misleading. Marathon stated that Mobil's $85 offer was "grossly inadequate" and disclosure of highly uncertain information indicating that Marathon had a net asset value of over $200 per share would only have supported this statement, and could have actually misled shareholders into thinking that the market would actually support a price of $200 per share.

C.

Starkman's contention that Marathon should have disclosed more information regarding its search for a white knight and its negotiations with Steel are equally without merit. The SEC and the courts have enunciated a firm rule regarding a tender offer target's duty to disclose ongoing negotiations: so long as merger or acquisition discussions are preliminary, general disclosure of the fact that such alternatives are being considered will suffice to adequately inform shareholders; a duty to disclose the possible terms of any transaction and the parties thereto arises only after an agreement in principle, regarding such fundamental terms as price and structure, has been reached. *See* Item 7 of Schedule 14D-9, 17 C.F.R. § 240.14d-101 (1984); *Greenfield* v. *Hublein, Inc.*, 742 F.2d 751, 756-57 (3d Cir. 1984), *cert. denied*, — U.S. —, 105 S.Ct. 1189 (1985) (rejecting an "intent to merge" trigger standard); *Staffin* v. *Greenberg*, 672 F.2d 1196, 1207 (3d Cir.

1982); *Reiss* v. *Pan American World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983).[9]

The rationale emerging from these cases is that when dealing with complex bargaining which may fail as well as succeed and which may succeed on terms which vary greatly from those originally anticipated, the disclosure of preliminary discussions could very easily mislead shareholders as to the prospects of success, and by making public an impending offer, push the price of the target's stock toward the expected tender price, thereby depriving shareholders of the primary inducement to tender — a premium above market price — and forcing the offeror to abandon its plans or greatly increasing the cost of the offer. *See Staffin* v. *Greenberg*, 672 F.2d at 1207.

In the instant case, Marathon's shareholder recommendation letter and its Schedule 14D-9 stated that the company was considering a number of alternatives, including a merger with another firm. These statements adequately informed the shareholders of Marathon's plans. Additional statements in these documents to the effect that Marathon's board believed the best result would be for Marathon to remain independent were not misleading when read in their full context, and at most expressed a sincere hope which the board found unrealistic under the pressure of Mobil's offer.

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[9] *Greenfield* v. *Hublein* also held that Hublein's voluntary statement in response to a New York Stock Exchange inquiry that it knew of no reason for an unusual increase in trading activity in its stock when in fact it knew of ongoing merger negotiations was not false or misleading because the merger negotiations had not been formally disclosed and there was no indication that the information had been leaked or that insider trading had occurred. 742 F.2d at 759. This holding is directly contrary to the position taken by the SEC in that case as amicus that while a company may respond with "no comment" to stock exchange inquiries regarding unusual market activity, it may not state that no corporate development accounts for the stock activity when in fact it knows that merger negotiations are under way. This related position has not altered the Commission's longstanding policy that negotiations need not otherwise be disclosed unless an agreement in principle has been reached.

Finally, Starkman's claims for fraud and breach of fiduciary duty are completely unsupported by authority in his brief, and were similarly neglected in his arguments below. We therefore affirm and adopt the reasoning of the District Court finding that no claim for fraud has been made out because Marathon did not fail to disclose any information necessary to make its other public statements not misleading, and that the directors' statements, made at a time of extraordinary pressure on the board, comported in all respects with federal law and did not breach a fiduciary duty to Marathon's shareholders.

Accordingly, the judgment of the District Court is affirmed.

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF OHIO
WESTERN DIVISION

IRVING STARKMAN,

Plaintiff

v. C-1-82-479

MARATHON OIL COMPANY,
et al.,

Defendants

ORDER GRANTING DEFENDANTS'
MOTION FOR
SUMMARY JUDGMENT (Doc. No. 66)

This matter is before the Court on defendants' Motion for Summary Judgment (Doc. No. 66). For the reasons which follow, defendants' Motion will be granted.

Facts

This lawsuit arose out of events surrounding the abortive attempt by Mobil Corporation (hereinafter "Mobil") to acquire defendant Marathon Oil Company (hereinafter "Marathon") and the

subsequent successful tender offer and merger involving Marathon and United States Steel Corporation (hereinafter "U.S. Steel"). Much of this factual background was explored in detail prior to and during the trial in this Court of Radol v. Thomas, C-1-82-13 (S.D. Ohio 1983). A brief review is in order.

On October 30, 1981, Mobil announced an offer to purchase up to 40 million shares of Marathon at $85.00 per share. At that time, Marathon was a publicly held corporation with approximately 58,685,906 shares outstanding. Marathon's directors, defendants herein, determined to resist the takeover attempt by Mobil. Pursuant to their decision, they retained First Boston Corporation (hereinafter "First Boston") to explore alternatives to the Mobil offer, including possible negotiations with potential "white knights."

As early as June of 1981, as a precaution against the possibility of a hostile takeover attempt, Marathon's president, defendant Harold Hoopman, ordered the preparation of an asset valuation which has come to be known as the "Strong Report." This internal document valued Marathon's assets at $276 to $323 per share.

At approximately the same time, First Boston was directed to prepare a similar evaluation. The ensuing document, known as the "First Boston Report," valued Marathon's assets at $189 to $226 per share.

The calculations in both the Strong and First Boston Reports were based on necessarily imprecise speculations and assumptions, including economic predictions as far as a half century into the future and far-reaching projections of the price of oil. Both of these documents

were developed as selling documents for use in attracting favorable tender offers.

The Strong Report was completed on October 30, 1981, and presented to the Marathon board at an emergency meeting the following day. At that same meeting, the tentative results of the First Boston Report were presented orally, although the written document was not presented until a meeting of the Marathon board on November 5, 1981.

Discussions between Marathon and U.S. Steel began on November 9, 1981, and an Agreement of Merger between the two companies was signed on November 18. The following day, the U.S. Steel tender offer was made public. Under the terms of the offer, U.S. Steel offered $125 per share for slightly over 51% of the outstanding Marathon shares. For all other shares, U.S. Steel proposed a subsequent

merger whereby each share of Marathon stock would be exchanged for a 12-1/2%, twelve-year U.S. Steel note with a face value of $100. The U.S. Steel offer was subsequently approved by a vote of the Marathon shareholders and the merger consummated.

Plaintiff was the owner of 50 Marathon shares. He sold his shares on the open market on November 18, 1981, one day before the U.S. Steel offer was publicly announced. He received a price of $78 per share.

Causes of Action

In his recently-filed Second Amended Complaint, plaintiff alleges three causes of action.[1]/ He alleges one cause of action under the federal securities laws for violation of Section 10(b) of the Securities Exchange Act of 1934,

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[1]/ Footnote omitted.

15 U.S.C. §78j(b), and Rule 10b-5, 17 C.F.R. §240.10b-5; one cause of action for common law fraud, and one cause of action for breach of fiduciary duty.

Plaintiff's federal cause of action is premised on defendants' alleged failure to disclose certain material information. Plaintiff argues that, as a result, he was induced to sell his shares in the market at $78 per share rather than hold them for the higher price offered under the agreement with U.S. Steel. Plaintiff lists the following as material information not disclosed: (1) the contents of the Strong Report; (2) the contents of the First Boston Report; (3) the contents of a report containing five-year projected earnings and cash flow estimates for Marathon; (4) the fact that Marathon had retained First Boston to seek out prospective purchasers; (5) the fact that First

Boston used the Strong and First Boston Reports and the earnings and cash flow estimates in concluding that Mobil's offer of $85 per share was too low; (6) the fact that Marathon commenced negotiations with U.S. Steel on November 9, 1981; (7) the fact that, in evaluating its position, "U.S. Steel required the five-year earnings and cash flow projections;" and (8) the "fact that the statements in Marathon's Schedule 14D-9. . .were false" and that Marathon was, at the time that the Schedule was mailed, seeking a higher bidder for the company.

Plaintiff's second cause of action alleges that the above failures to disclose constituted common law fraud.Plaintiff's third cause of action alleges that the same failures to disclose constituted a breach of fiduciary duty by defendant directors. Defendants have moved for summary judgment on all counts.

Summary Judgment Standard

The summary judgment standard in this Circuit is a stringent one. Federal Rule of Civil Procedure 56(c) permits the Court to grant summary judgment only when there is no genuine issue of material fact and when the moving party is entitled to judgment as a matter of law. Sartor v. Arkansas Natural Gas Corp., 321 U.S. 620 (1944); Watkins v. Northwestern Ohio Tractor Pullers, 630 F.2d 1155, 1158 (6th Cir. 1980). The Court may not make findings of disputed facts on a Motion for Summary Judgment. Watkins, supra. The movant has the burden of showing conclusively that there exists no genuine issue as to a material fact, and the evidence together with all inferences to be drawn therefrom must be considered in the light most favorable to the party opposing the Motion. Id. The movant's papers are to be closely scrutinized,

while those of the opposing party are to be viewed indulgently. Id. The Court will consider this Motion in accordance with the foregoing standards.

Discussion

A. Federal Claims:

Section 10(b) of the Securities Exchange Act, 15 U.S.C. §78j(b), provides, in pertinent part,

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange. . .
>
> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, 17 C.F.R. §240.10b-5, promulgated thereunder, provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

As is evident from the language of Rule 10b-5(2), the omission of a fact is a violation of the Rule only when the fact is "material" and necessary in order to make the statements that were made not misleading under the circumstances. Even assuming the materiality of the information contained in the Strong and First

Boston Reports,[2/] plaintiff's arguments founder on the second test of Rule 10b-5(2).

An examination of Marathon's public statements and communications with its shareholders during the period in question here, including particularly its Schedule 14D-9 filed with the Securities Exchange Commission on November 2, 1981, reveals that Marathon stated consistently, at every opportunity, its opinion, and that of First Boston, that Mobil's offer of $85 per share was "grossly inadequate." See, e.g., Schedule 14D-9,

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2/ In Radol v. Thomas, 556 F.Supp. 586 (S.D. Ohio 1983), this Court held that, under the materiality standard in TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976), the Court could not say, as a matter of law, that the asset valuations in the two Reports were not material. Radol, supra, at 594. A jury ultimately decided that the information in the Reports was, in fact, not material. However, the Court need not address that question.

Item 4(a); Letter to Marathon Shareholders of November 2, 1981; Marathon News Release of November 2, 1981 (see Exhibit A to Doc. No. 66); Letter to Marathon Shareholders of November 12, 1981 (see Exhibit F to Doc. No. 66); Press Release of November 11, 1981; Press Release of November 13, 1981 (see Exhibit G to Doc. No. 66). The information contained in the Strong and First Boston Reports indicated a Marathon asset value far in excess of $85 per share, and was thus consistent with Marathon's statements to its shareholders and the public. The disclosure of information which is consistent with other statements made is obviously not necessary in order to make those statements not misleading. Such disclosure would simply reinforce, rather than correct or modify, the statements made, and it is therefore not required.

Such is the case with the Strong and First Boston Reports as they relate to Marathon's characterization of Mobil's offer. Disclosure of the information contained in the Reports was not required under Rule 10b-5, because the failure to disclose that information did not render misleading Marathon's repeated statement that Mobil's offer was "grossly inadequate."

Plaintiff, however, argues[3/] that the failure to disclose the information in the Reports did render certain other statements by Marathon misleading. He focuses on language in Marathon's Schedule 14D-9 and in defendant Hoopman's November 2, 1981, letter to shareholders stating that the success of the Mobil offer was "highly problematical," that the directors believed "that this is an

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3/ Omitted.

extremely inopportune time to sell the [c]ompany," and that the "shareholders would be better served if the [c]ompany were to remain independent." Plaintiff arques that these statements are misleading without disclosure of the contents of the Strong and First Boston Reports.

The Court disagrees. The statements spotlighted by plaintiff cannot be read in a vacuum. Consideration of other statements in the Schedule 14D-9, expressing the directors' opinion that the Mobil offer was "grossly inadequate" (Item 4(a)) and indicating that alternatives, including the sale of all or part of Marathon to another buyer, were being explored (Item 7(a)), makes clear that the language cited by plaintiff had to be interpreted in the context of the pending Mobil offer. In that context, made evident by the contemporaneous statements in the Schedule 14D-9, the meaning of the

language on which plaintiff focuses was clear, and disclosure of the Strong and First Boston Reports was not needed to make it so. Consequently, defendants' non-disclosure of the contents of those Reports did not violate Rule 10b-5 or §10(b) of the Exchange Act.

There was likewise no violation of the Act as a result of the non-disclosure of Marathon's projected earnings and cash flow estimates. Disclosure of such information is not required. Marsh v. Armada Corp., 533 F.2d 978, 986-87 (6th Cir. 1976); Arber v. Essex Wire Corp., 490 F.2d 414, 421 (6th Cir. 1974).

Plaintiff also alleges that defendants should have disclosed the facts that First Boston had been retained "to solicit prospective purchasers" and that First Boston used the Strong and First Boston Reports and projected earnings and cash flow estimates in soliciting other

offers. The fact is that the retention of First Boston and the purposes therefor were clearly disclosed in Item 7 of the Schedule 14D-9. With respect to information used in First Boston's "sales pitch," plaintiff has not pointed to, nor is the Court aware of, any independent requirement that such information be disclosed.

Similarly, plaintiff cites no statutory or case authority in support of his contention that defendants were required to disclose the fact that U.S. Steel used Marathon's projected earnings and cash flow in evaluating its own position with respect to a possible merger. The information itself was not material, Marsh, supra, and there is no independent duty to disclose the fact that U.S. Steel may have considered it.

Plaintiff also asserts that defendants should have disclosed the fact that

negotiations were begun on November 9, 1981, between Marathon and U.S. Steel for the purchase of Marathon shares at a price higher than $85 per share. Here again, Marathon's disclosures comported with the requirements of the securities laws.

As noted above, Marathon's Schedule 14D-9 disclosed that the acquisition of all or part of Marathon by another company was being explored as an alternative to the Mobil offer. Further disclosure was not required. As the United States Court of Appeals for the Second Circuit recently stated in Reiss v. Pan American World Airways, Inc., 711 F.2d 11, 14 (2nd Cir. 1983),

> It does not serve the underlying purposes of the securities acts to compel disclosure of merger negotiations in the not unusual circumstances before us. Such negotiations are inherently fluid and the eventual outcome is shrouded in uncertainty. Disclosure may in fact be more misleading than

> secrecy so far as investment decisions are concerned. We are not confronted here with a failure to disclose hard facts which definitely affect a company's financial prospects. Rather, we deal with complex bargaining between two (and often more) parties which may fail as well as succeed, or may succeed on terms which vary greatly from those under consideration at the suggested time of disclosure. (citations omitted).

See also Staffin v. Greenberg, 672 F.2d 1196, 1206 (3rd Cir. 1982) (preliminary merger discussions immaterial as a matter of law.) In line with this authority, the Court holds that defendants' disclosures with respect to other merger negotiations, including those commenced with U.S. Steel, were adequate as a matter of law.

Finally, plaintiff contends that "the statements in Marathon's Schedule 14D-9, as above alleged, were false" and that "Marathon was in fact seeking a higher bidder." This contention is

meritless. As the Court's foregoing discussion makes clear, Marathon's Schedule 14D-9 was accurate and complete, and it comported with the requirements of the applicable securities laws. Plaintiff's sweeping assertion to the contrary is simply without foundation.

In summary, the Court holds that there has been no violation of the federal securities laws by defendants. Summary judgment for defendants will be granted with respect to plaintiff's federal claims.

B. State and Common Law Claims

Plaintiff's claims for fraud and breach of fiduciary duty receive virtually no attention in the documents submitted by the parties and merit little discussion here. Those claims are premised entirely on the allegations underlying plaintiff's federal cause of action. As explained above, the information alleged-

ly not disclosed by defendants was either not material, not misleading by its omission, or not, in fact, omitted. Each of these three circumstances is sufficient, without more, to defeat a claim of common law fraud. See Crocker v. Manley, 164 Ill. 282, 45 N.E. 577 (1896) (elements of fraud - Illinois); Malewski v. Mackiewich, 282 Ill. App. 593 (1935) (same); Greenwalt v. Goodyear Tire & Rubber Co., 164 Ohio St. 1, 128 N.E. 2d 116 (1955) (elements of fraud - Ohio). Accordingly, the Court holds that defendants are entitled to summary judgment on plaintiff's common law fraud claim.

In light of the foregoing discussion, it is readily apparent that defendant directors did not breach their fiduciary duty to Marathon shareholders. Their statements to those shareholders and to the public, made at a time of extraordinary pressure on the board,

comported in all respects with federal law and clearly reflected the directors' concern with the best interests of the company and its shareholders in the face of what the board perceived to be an unfavorable takeover attempt by Mobil. That the directors were ultimately able to negotiate an agreement with U.S. Steel more favorable to Marathon's shareholders than Mobil's offer reinforces the Court's conclusion. Summary judgment will be granted for defendants on plaintiff's breach of fiduciary duty claim.

Summary

Based on the foregoing, the Court finds that there exists no genuine issue of material fact and that defendants are entitled to judgment as a matter of law on all counts of plaintiff's Complaint. Accordingly, defendants' Motion for

Summary Judgment (Doc. No. 66) is hereby GRANTED.

IT IS SO ORDERED.

/S/ _____
Carl B. Rubin, Chief Judge
United States District Court